

Internal Revenue Service

Appeals Office
312 Elm Street, Suite 2330
Cincinnati, OH 45202-2763

Department of the Treasury

Taxpayer Identification Number:
D

Release Number: **201315037**

Release Date: **4/12/2013**

Date: **January 14, 2013**

Person to Contact:

A
B
C

Tax Period(s) Ended:

UIL: 501.03-00

Certified Mail

Dear

This is the final adverse determination regarding your exempt status under section 501(a) of the Internal Revenue Code (the "Code"). It is determined that you do not qualify for recognition of exemption from Federal income tax under section 501(a) of the Code, as an organization described in section 501(c)(3) of the Code, effective January 1, 2007.

Our adverse determination was made for the following reason(s):

You are not operating exclusively for exempt purposes within the meaning of section 501(c)(3) of the Code. Specifically a substantial amount of your organization's assets inured to the personal benefit of your founder. You also failed to adequately maintain contemporaneous books and records as required of a section 501(c)(3) organization.

Contributions to your organization are not deductible under section 170 of the Code.

You are required to file Federal income tax returns on Forms 1120 for the tax periods stated in the heading of this letter and for all tax years thereafter. File your return with the appropriate Internal Revenue Service Center per the instructions of the return. For further instructions, forms, and information please visit www.irs.gov.

Processing of income tax returns and assessments of any taxes due will not be delayed should a petition for declaratory judgment be filed under section 7428 of the Code.

If you decide to contest this determination, you may file an action for declaratory judgment under the provisions of section 7428 of the Code in one of the following three venues: 1) United States Tax Court, 2) the United States Court of Federal Claims, or 3) the United States District Court for the District of Columbia. A petition or complaint in one of these three courts must be filed within 90 days from the date this determination letter was mailed to you. Please contact the clerk of the appropriate court for rules for filing petitions for declaratory judgment. To secure a petition form from the United States Tax Court, write to the United States Tax Court, 400 Second Street, N.W., Washington, D.C. 20217. See also Publication 892.

You also have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States Court. The Taxpayer Advocate can however, see that a tax matter that

may not have been resolved through normal channels gets prompt and proper handling. If you want Taxpayer Advocate assistance, please contact the Taxpayer Advocate for the IRS office that issued this letter. You may call toll-free, 1-877-777-4778, for the Taxpayer Advocate or visit www.irs.gov/advocate for more information.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely Yours,

Appeals Team Manager

Enclosure: Publication 892

CC:

Internal Revenue Service
Tax Exempt and Government Entities Division
Exempt Organizations: Examinations
Attention: Jeffrey Davis, MailStop 39
2303 W. Meadowview Road
Greensboro, NC 27407

Department of the Treasury

LEGEND

ORG – Organization name
ADDRESS – address XX - Date

Date: September 8, 2011

Taxpayer Identification Number:
Form:
Tax Year(s) Ended:
Person to Contact/ID Number:
Contact Numbers:
Telephone:
Fax:

ORG
ADDRESS

Certified Mail – Return Receipt Requested

Dear :

We have enclosed a copy of our report of examination explaining why we believe revocation of your exempt status under section 501(c)(3) of the Internal Revenue Code (Code) is necessary.

If you accept our findings, please sign and return the enclosed Form 6018, Consent to Proposed Action - Section 7428. If you have already given us a signed Form 6018, you need not repeat this process. We will issue a final revocation letter.

If you do not agree with our proposed revocation, you must submit to us a written request for Appeals Office consideration within 30 days from the date of this letter to protest our decision. Your protest should include a statement of the facts, the applicable law, and arguments in support of your position.

An Appeals officer will review your case. The Appeals office is independent of the Director, EO Examinations. The Appeals Office resolves most disputes informally and promptly. The enclosed Publication 3498, *The Examination Process*, and Publication 892, *Exempt Organizations Appeal Procedures for Unagreed Issues*, explain how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

You may also request that we refer this matter for technical advice as explained in Publication 892. If we issue a determination letter to you based on technical advice, no further administrative appeal is available to you within the IRS regarding the issue that was the subject of the technical advice.

If we do not hear from you within 30 days from the date of this letter, we will process your case based on the recommendations shown in the report of examination. If you do not protest this proposed determination within 30 days from the date of this letter, the IRS will consider it to be a

failure to exhaust your available administrative remedies. Section 7428(b)(2) of the Code provides, in part: "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted its administrative remedies within the Internal Revenue Service." We will then issue a final revocation letter. We will also notify the appropriate state officials of the revocation in accordance with section 6104(c) of the Code.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Nanette M. Downing
Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Report of Examination
Form 6018 (2)
Envelope

Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS		Schedule number or exhibit
Name of taxpayer ORG	Tax Identification Number EIN	Year/Period ended December 31, 20XX December 31, 20XX	

LEGEND

ORG - Organization name XX - Date Apartment - apartment City - city
State - state County - county Founder - founder EIN - ein VIR-1 &
VIR-2 - 1st & 2nd VIR CO-1 through CO-18 - 1st through 18th COMPANIES

ISSUE:

Whether ORG qualifies for exemption under Section 501(a) as described in Section 501(c)(3) of the Internal Revenue Code?

FACTS:

ORG (the Organization) was formed and incorporated in the state of State on February 5, 20XX. The president and founder of the Organization, Founder, had a healthy personal cat named ORG. ORG would go on to contract VIR-1 during 20XX. After receiving treatment and seemingly improving, ORG later succumbed to the disease in October of 20XX. Following the loss of ORG, Founder decided to start an organization that would educate the public about feline retroviruses.

The Organization submitted its Form 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code, in October of 20XX. It was received by the Internal Revenue Service on October 26, 20XX. The Organization's purpose as stated in the application was to produce a calendar to be used in soliciting donations for research into a cure for and/or vaccine against VIR-1. After producing the calendar and raising funds, the Organization would then present those funds to research and veterinary facilities.

The Organization was originally granted exemption on November 16, 20XX as an organization exempt from federal income taxes under Internal Revenue Code (IRC) Section 501(a), as described in IRC Section 501(c)(3), and further described in Sections 509(a)(1) and 170(b)(1)(A)(vi) for its advanced ruling period. After the advanced ruling period, the Organization was granted its final determination letter on March 20, 20XX to remain exempt as described above.

Examination of the Organization yielded two primary activities: an educational role in which the Organization educates the public about feline retroviruses, namely VIR-1 (VIR-1) and VIR-2 (VIR-2) (potentially terminal viruses that inhibits a cat's immune system); and as an animal shelter that houses felines infected with VIR-1 and VIR-2, and fosters these cats for adoption.

The Organization educates the public about the VIR-1 and VIR-2 diseases (which may lie dormant for years without any symptoms) through public service announcements, promoting awareness, distribution of information about retroviruses (and the Organization) to veterinary offices and animal rescue groups, a website that is used as a resource tool for awareness, and national recognition for the Organization's work in CO-1. There is no cure for VIR-1 or VIR-2. Some methods used to educate the public of the Organization's issue include:

- Yearly "Test Your Pet" days in which the Organization tests cats for the VIR-1 and VIR-2 viruses. This opportunity is also used to educate pet owners of the diseases and bring awareness to the Organization's mission.

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- The Organization creates yearly "ORG Calendars" for distribution. The calendar includes the story behind the Organization, educational information about the diseases, and encourages testing.
- The Organization has designed and patented the "ORG" for pets. The tents provide a place for a cat or dog to sleep, but serves as educational tools as each tent includes a tag that contains information about the retroviruses.

In addition to its educational activities, the Organization also wanted to provide an alternative to immediate euthanasia to asymptomatic felines who carry the viruses. The Organization expanded their activities to provide an animal shelter to VIR-1 and VIR-2 infected cats, and foster the adoptions of these cats to permanent homes. The Organization uses an apartment within Apartment, a residential apartment complex in City, State, as an animal shelter to house cats infected with VIR-2, and a separate smaller facility to house the cats infected with VIR-1. The cats infected with VIR-1 are housed separately due to the disease being more contagious and deadlier than VIR-2.

The Organization organized numerous adoption meet and greets, held at local pet stores, which allows the opportunity for the community to visit with and adopt cats under the Organization's care. This also provided an educational opportunity for the public and allowed the community to speak with informative adoption representatives.

The Organization also conducted several fundraisers to raise money to further its purpose. Some fundraising events included a golf tournament, holiday gift wrapping at the local mall, and its anniversary celebration and auction, which included the auction of donated items, some of which were from celebrities.

The Organization incurred related business expenses such as food and cat litter for the cats at both locations. The Organization also incurred expenses related to providing limited free VIR-1 and VIR-2 testing (given on a first come, first serve basis) at annual education awareness events in the area, expenses related to fostering adoptions at the local pet store, veterinarian expenses for incoming cats and cats currently in the Organization's care, and fundraising expenses.

Review of the bank statements yielded that the Organization also incurred various questionable expenses. The Organization paid the full amount of rent to Apartment, a residential apartment complex in City, State. Review of the leasing agreements of the apartment (which covered 4/1/XX – 3/31/XX and 4/1/XX – 3/31/XX) yielded that Founder's name is the only name listed as the lessee. There is no mention of the Organization in the lease agreement.

The lease agreements also contains language that limits the pet occupancy of the residence to a maximum of 2 (two) animals per residence. The pet limitation was enacted with its current pet policy in 20XX. The apartment complex allows those occupants with leases, and subsequent lease renewals, entered into before the enactment of the pet policy to remain excluded from the pet policy. Founder signed her initial lease agreement with the apartment complex in 20XX. The apartment in which the Organization operates, the unit leased to Founder, is excluded from the pet policy. The apartment serves as the Organization's headquarters and as an animal shelter.

Review of the bank statements also yielded that along with the rent expense, the Organization also paid all the utility expenses (cable, phone, internet services) and grocery expenses, as well as restaurant expenses, department store expenses (such as CO-2®, CO-3®, CO-4®, CO-5®, CO-6®),

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CO-7®, CO-8®, CO-9®, CO-10®, CO-11®, CO-12®, CO-13®, CO-14®, and CO-15®), gas station and convenient store expenses, and other miscellaneous expenses (such as trips to local movie theaters, purchases from CO-16, CO-17®, credit card payments, and purchases made at local alcohol stores). There were also multiple cash withdrawals taken from the Organization's bank accounts. Review of the cancelled checks yielded Founder as the primary signatory on some of the checks (when checks were signed by two individuals), and the only signatory on the remainder of the checks sampled. Founder's signature was viewed on all the checks sampled.

The Organization's Board of Directors meeting minutes were reviewed for the tax years under examination. From that review it was determined that while the Board of Directors discussed fund raising events, volunteer issues for events, and the Organization's web site, there was no discussion of the organization's financial expenditures. The Board of Directors meeting minutes were devoid of financial reports and also lacked discussions about personal expenditures made by Founder. The Board of Directors meeting minutes that were reviewed provided no evidence of financial oversight regarding the operations of the Organization, and no evidence that Founder had any limitations on her authority to expend money as she saw fit.

Source documents, including invoices and receipts, were requested by the Internal Revenue Service on multiple occasions to substantiate a sample of the expenses that seemed personal in nature. A request was made by the IRS on May 14, 20XX requesting photocopies of source documents and an explanation for a sample of questionable expenses that occurred throughout the 20XX tax year. The sample included at least one (1) questionable transaction that occurred during each month.

In response to the Service's May 14th request, on May 28, 20XX, The Organization indicated that the 20XX records were destroyed by cat urine. The Organization was able to provide explanations for the expenses identified, but only provided invoices to support three (3) of the expenses. The Organization did not provide any other documentation to support the explanations provided.

On June 16, 20XX, another request for information was sent to the Organization. Along with requesting information from the previous request (sent May 14, 20XX) for the second (2nd) time, documentation for all grocery and general retail purchases, restaurant purchases, and gas station and convenience store purchases made during four (4) months of the year (April, May, July, and October) were requested. Photocopies of the documents were requested to reduce and/or eliminate the handling of the original documents that were contaminated by cat urine.

The Organization's response to the June 16th request for information was received July 8, 20XX. The Organization's response provided a written narrative explaining the business purpose of the expenses. Also included was a front and back copy of a cancelled check that was written to the Organization, but was deposited by a veterinarian hospital. The Organization also provided pictures of items to substantiate purchases made at CO-18® and CO-15®, and pictures taken at a local sports bar in which the Organization asserts it held a poker tournament fundraiser. None of the pictures contained dates to identify when the photographs were taken. The response did not include any receipts or a breakdown of any expenses related to conducting a poker tournament at a sports bar. The response also included grocery and general retail receipts from the 20XX and 20XX years showing only examples of purchases related to the business throughout the year. The receipts related to the 20XX and 20XX tax years provided no information in regards to the 20XX and 20XX tax years under examination.

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The Organization was unable to provide any source documents to substantiate many of the sampled expenses were ordinary and necessary business expenses in the year under examination.

Founder has been in charge of the Organization, and its day-to-day operations, since its inception as its President. According to the Organization's bylaws: "the president shall be the principal executive officer and shall in general supervise and control all of the business and affairs of the corporation...and shall have general charge and control over the affairs of the corporation subject to such regulations and restrictions as the Board of Directors shall from time to time determine." Founder does not receive any monetary remuneration for the work she provides to the Organization.

The Organization requires at least one individual to be present at the apartment at all times. The on-site manager for the apartment is Founder. Volunteers are used to supervise the animals when Founder is not at the facility. The June 16th request also included a request for a list of volunteers during the 20XX year. The Organization failed to submit a list of volunteers for the 20XX tax year beyond its Board of Directors.

A tour of the residence yielded numerous felines with "free reign" of the apartment. The apartment consisted of 1160 square feet (ft²) and included two (2) bedrooms, two (2) bathrooms, a kitchen, a living room, and a dining room. See EXHIBIT 2 for a copy of the floor plan from the complex's website. Televisions were in both bedrooms and the living area. Only a minimum number of cats were confined to cages; the majority of the cats was not caged and was not confined to a specific room. The cats that were in cages were in the 13' X 15' bedroom; there were no other discernible uses for the bedroom.

The Organization is operating the apartment as an animal shelter within the city limits of City, State (located in County, State). See EXHIBIT 3 for a Map® Maps location of the Organization's location and address (with circled reference points). According to the County, State Zoning Ordinance, an animal shelter must be located in a "Rural Agriculture" (RA) district within the county. Among other requirements, an animal shelter must also be at least three-hundred feet (300ft) from any residence. See EXHIBIT 4 for a portion of the County, State Zoning Ordinance that references animal shelters. See EXHIBIT 5 for a portion of the zoning map of County, State relating to the location of the Organization (with circled reference points that corresponds with EXHIBIT 3).

The Internal Revenue Service's initial reports of findings were sent to the Organization on September 20, 20XX identifying questionable transactions totaling \$. The Organization was given thirty (30) days to prepare a formal response to provide its position to the Service's findings, and to provide any additional information to substantiate its position and/or rebut the Service's position. Due to the information being gathered, and the reliance on third-parties, the Organization requested an extension to provide its official response. The Organization was granted a two (2) week extension to the thirty-day response period, extending the response deadline to November 3, 20XX.

The Organization provided its position in a formal response to the Service's report on November 3, 20XX. Along with the Organization's official response, the Organization submitted documentation, including but not limited to copies of source documents for supplies, shipping expenses, grocery expenses, and other miscellaneous expenses, to substantiate its position. The new information, including source documents, was taken into consideration for purposes of substantiating the questionable expenses as legitimate business expenses. After review of the new information, the total questionable expenses and transactions that could not be substantiated by the Organization as

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legitimate business expenses totaled \$ for the 20XX tax year. See EXHIBIT 1 for a breakdown of the questionable expenses.

Upon review of the Organization's formal response and position, a subsequent year examination was initiated. The tax year being examined, tax year ending December 31, 20XX, was an issue-focused examination. The examination would focus primarily on the expenses of the Organization, whether any improper transactions occurred, and whether there was a pattern of abusive behavior by the individuals in charge of the Organization.

On December 1, 20XX, a request was sent to the organization to review all receipts, invoices, vouchers, and any other source documents for transactions that occurred during the tax year ended December 31, 20XX. The review was set to take place on December 15, 20XX at the office of the Organization's representative. At the request of the Organization, the review date was rescheduled to December 28, 20XX to allow the Organization time to obtain more source documents from third parties as it did not have many receipts on hand.

Due to inclement winter weather, the December 28, 20XX appointment was rescheduled to January 4, 20XX.

The Organization provided receipts for veterinary visits and shipping with the United States Postal Service (USPS), but provided little else in regards to billing invoices, source documents, and receipts for other transactions on January 4, 20XX. Along with the veterinary receipts, the Organization also provided recent correspondence between the examining agent and the Organization, bank statements and cancelled checks for the 20XX tax year, correspondence information regarding applications by the Organization to receive grants and contributions, correspondence (some signed and dated, others not) from third-parties indicating that the Organization made purchases from their business, residential lease agreements (one executed, one not executed), and updated information regarding the activities of the Organization including past years animal shelter licensing and inspection information, volunteer contracts regarding waiver of liability and code of conduct, fundraising flyers, and adoption events.

On January 14, 20XX an additional request was made of the Organization to provide photocopies of receipts, invoices, and any other source documents, as well as explanations, for questionable expenses including rent and utility expenses, department store purchases, grocery and general retail purchases, restaurant purchases, gas station and convenience store purchases, cash withdrawals, shipping and supply purchases, and miscellaneous purchases identified on an attached Excel® spreadsheet. The Organization was also asked to provide a written position with regard to the questionable expenses, how these expenses are not personal in nature to Founder, and the basis for these expenses to be excluded from the personal income of Founder.

In response to the Service's January 14th request, on February 4, 20XX, the Organization submitted minimal receipts and source documents to substantiate the expenses identified on the January 14, 20XX request. Along with some new receipts, the organization re-submitted the information submitted January 4, 20XX. This included recent correspondence between the examining agent, the Organization, and its representative; bank statements and cancelled checks; correspondence between the Organization and other organizations regarding grants/contributions and expenses; animal shelter licensing and inspection information; residential lease agreements (one executed, one not executed); volunteer contracts regarding waiver of liability and code of conduct; and information regarding the Organization's activities, including but not limited to flyers for upcoming events,

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schedule of fundraising event(s), event agendas, adoption information, and visits to local veterinarians.

The receipts that were submitted on February 4, 20XX were taken into account for determining which expenses qualified as legitimate business expenses.

The Organization failed to provide any source documents to substantiate many of the questionable expenses, a written position with regard to the questionable expenses, how said expenses were ordinary and necessary business expenses and not personal in nature to Founder, and the basis for these expenses to be excluded from the personal income of Founder. The total questionable expenses and transactions that could not be substantiated by the Organization as legitimate business expenses totaled \$ for the 20XX tax year. This amount was adjusted from \$ based on the Organization's submission of source documents received February 4, 20XX. See EXHIBIT 1 for a breakdown of the questionable expenses.

LAW:

Internal Revenue Code (IRC) §501(a) states that an organization described in subsection (c) or (d) shall be exempt from taxation under this subtitle unless such exemption is denied under Section 502 (concerning feeder organization) or Section 503 (concerning organizations engaged in prohibited transactions).

IRC §501(c) identifies in its subparagraphs the list of organizations referred to in subsection (a).

IRC §501(c)(3) exempts from taxation, corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation, and which does not participate in, or intervene in any political campaign on behalf of (or in opposition to) any candidate for public office.

IRC §501(d) states that the following organizations are referred to in subsection (a): Religious or apostolic associations or corporations, if such associations or corporations have a common treasury or community treasury, even if such associations or corporations engage in business for the common benefit of the members, but only if the members thereof include (at the time of filing their returns) in their gross income their entire pro rata shares, whether distributed or not, of the taxable income of the association or corporation for such year. Any amount so included in the gross income of a member shall be treated as a dividend received.

IRC §509(a) states in part for purposes of this title, the term "private foundation" means a domestic or foreign organization described in section 501(c)(3) other than

- (1) an organization described in section 170(b)(1)(A), other than clauses vii and viii,
- (2) an organization which

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(A) normally receives more than one-third of its support in each taxable year from any combination of —

(i) gifts, grants, contributions, or membership fees, and

(ii) gross receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities, in an activity which is not an unrelated trade or business, not including such receipts from any person, or from any bureau or similar agency of a governmental unit, in any taxable year to the extent such receipts exceed the greater of \$5,000 or 1 percent of the Organization's support in such taxable year,

from persons other than disqualified persons (as defined in §4946) with respect to the organization, from governmental units, or from organizations described in section 170(b)(1)(A) (other than in clauses (vii) and (viii)), and

(B) normally receives not more than one-third of its support in each taxable year from the sum of —

(i) gross investment income and

(ii) the excess (if any) of the amount of the unrelated business taxable income over the amount of the tax imposed by section 511.

IRC §170(b)(1)(A)(vi) states in part that an organization that normally receives a substantial part of its support (exclusive of income received in the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501(a)) from a governmental unit or from direct or indirect contributions from the general public.

IRC §119(a) states in part that there shall be excluded from gross income of an employee the value of any meals or lodging furnished to him (or her), his spouse, or any of his dependents by or on behalf of his employer for the convenience of the employer, but only if —

(1) in the case of meals, the meals are furnished on the business premises of the employer, or

(2) in the case of lodging, the employee is required to accept such lodging on the business premises of his employer as a condition of his employment.

IRC §119(b) states in part that for purposes of subsection (a) —

(1) In determining whether meals or lodging are furnished for the convenience of the employer, the provisions of an employment contract or of a State statute fixing terms of employment shall not be determinative of whether the meals or lodging are intended as compensation.

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- (2) In determining whether meals are furnished for the convenience of the employer, the fact that a charge is made for such meals, and the fact that the employee may accept or decline such meals, shall not be taken into account.

IRC §119(b)(3)(A) states in part that if —

- (i) an employee is required to pay on a periodic basis a fixed charge for his meals, and

- (ii) such meals are furnished by the employer for the convenience of the employer,

there shall be excluded from the employee's gross income an amount equal to such fixed charge.

IRC §119(b)(4) states in part that all meals furnished on the business premises of an employer to such employer's employees shall be treated as furnished for the convenience of the employer if more than half of the employees to whom such meals are furnished on such premises are furnished such meals for the convenience of the employer.

IRC §162(a) states in part that there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including —

- (1) a reasonable allowance for salaries or other compensation for personal services actually rendered;
- (2) traveling expenses (including amounts expended for meals and lodging other than amounts which are lavish or extravagant under the circumstances) while away from home in the pursuit of a trade or business; and
- (3) rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

IRC §262 provides in part that

- (a) Except as otherwise expressly provided, no deduction shall be allowed for personal, living, or family expenses.
- (b) For purposes of subsection (a), in the case of an individual, any charge (including taxes thereon) for basic local telephone service with respect to the 1st telephone line provided to any residence of the taxpayer shall be treated as a personal expense.

IRC §6001 states in part that every person liable for any tax imposed by this title, or for the collection thereof, shall keep such records, render such statements, make such returns, and comply with such rules and regulations as the Secretary may from time to time prescribe.

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IRC §6033(a)(1) states in part that except as provided in paragraph (3), every organization exempt from taxation under section 501(a) shall file an annual return, stating specifically the items of gross income, receipts, and disbursements, and such other information for the purpose of carrying out the internal revenue laws as the Secretary may by forms or regulations prescribe, and shall keep such records, render under oath such statements, make such other returns, and comply with such rules and regulations as the Secretary may from time to time prescribe.

IRC §6033(a)(3)(A) states in part that the above paragraph shall not apply to —

- (i) churches, their integrated auxiliaries, and conventions or associations of churches,
- (ii) any organization (other than a private foundation, as defined in section 509(a)) described in subparagraph (C), the gross receipts of which in each taxable year are normally not more than \$5,000, or
- (iii) the exclusively religious activities of any religious order.

Treasury Regulation §1.501(a)-1(c) states that the words "private shareholder or individual" in section 501 refer to persons having a personal and private interest in the activities of the organization.

Treasury Regulation §1.501(c)(3)-1(c)(1) states in part that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Treasury Regulation §1.501(c)(3)-1(c)(2) states in part that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

Treasury Regulation §1.501(c)(3)-1(d)(1) states in general

- (i) An organization may be exempt as an organization described in section 501(c)(3) if it is organized and operated exclusively for one or more of the following purposes:
 - (a) Religious,
 - (b) Charitable,
 - (c) Scientific,
 - (d) Testing for public safety,
 - (e) Literary,
 - (f) Educational, or
 - (g) Prevention of cruelty to children or animals.
- (ii) An organization is not organized or operated exclusively for one or more of the purposes specified in subdivision (i) of this subparagraph unless it serves a public rather than a private interest. Thus, to meet the requirement of this subdivision, it is necessary for an organization to establish that it is not organized or operated for

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the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Treasury Regulation §1.501(c)(3)-1(f)(2)(ii) states in part that in determining whether to continue to recognize the tax-exempt status of an applicable tax-exempt organization described in section 501(c)(3) that engages in one or more excess benefit transactions that violate the prohibition on inurement under section 501(c)(3), the Commissioner will consider all relevant facts and circumstances, including, but not limited to, the following —

- (A) The size and scope of the organization's regular and ongoing activities that further exempt purposes before and after the excess benefit transaction or transactions occurred;
- (B) The size and scope of the excess benefit transaction or transactions (collectively, if more than one) in relation to the size and scope of the organization's regular and ongoing activities that further exempt purposes;
- (C) Whether the organization has been involved in multiple excess benefit transactions with one or more persons;
- (D) Whether the organization has implemented safeguards that are reasonably calculated to prevent excess benefit transactions; and
- (E) Whether the excess benefit transaction has been corrected (within the meaning of section 4958(f)(6), meaning in respect to any excess benefit transaction, undoing the excess benefit to the extent possible, and taking any additional measures necessary to place the organization in a financial position not worse than that in which it would be if the disqualified person were dealing under the highest fiduciary standards), or the organization has made good faith efforts to seek correction from the disqualified person(s) who benefited from the excess benefit transaction.

Treasury Regulation §1.501(c)(3)-1(f)(2)(iii) states that all factors will be considered in combination with each other. Depending on the particular situation, the Commissioner may assign greater or lesser weight to some factors than to others. The factors listed in paragraphs (f)(2)(ii)(D) and (E) of this section will weigh more heavily in favor of continuing to recognize exemption where the organization discovers the excess benefit transaction or transactions and takes action before the Commissioner discovers the excess benefit transaction or transactions. Further, with respect to the factor listed in paragraph (f)(2)(ii)(E) of this section, correction after the excess benefit transaction or transactions are discovered by the Commissioner, by itself, is never a sufficient basis for continuing to recognize exemption.

Treasury Regulation §1.501(c)(3)-1(f)(3) states that the rules in paragraph (f) of this section will apply with respect to excess benefit transactions occurring after March 28, 20XX.

Treasury Regulation §1.119-1(a)(1) states in part that the value of meals furnished to an employee by his employer shall be excluded from the employee's gross income if two tests are met: (i) The meals

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are furnished on the business premises of the employer, and (ii) the meals are furnished for the convenience of the employer. The question of whether meals are furnished for the convenience of the employer is one of fact to be determined by analysis of all the facts and circumstances in each case. If the tests described in subdivisions (i) and (ii) of this subparagraph are met, the exclusion shall apply irrespective of whether under an employment contract or a statute fixing the terms of employment such meals are furnished as compensation.

Treasury Regulation §1.119-1(a)(2)(i) states in part that meals furnished by an employer without charge to the employee will be regarded as furnished for the convenience of the employer if such meals are furnished for a substantial noncompensatory business reason of the employer. If an employer furnishes meals as a means of providing additional compensation to his employee (and not for a substantial noncompensatory business reason of the employer), the meals so furnished will not be regarded as furnished for the convenience of the employer.... In determining the reason of an employer for furnishing meals, the mere declaration that meals are furnished for a noncompensatory business reason is not sufficient to prove that meals are furnished for the convenience of the employer, but such determination will be based upon an examination of all the surrounding facts and circumstances.... If the employee is required to occupy living quarters on the business premises of his employer as a condition of his employment (as defined in paragraph (b) of this section), the exclusion applies to the value of any meal furnished without charge to the employee on such premises.

Treasury Regulation §1.119-1(a)(2)(ii) provides in part that

- (a) Meals will be regarded as furnished for a substantial noncompensatory business reason of the employer when the meals are furnished to the employee during his working hours to have the employee available for emergency call during his meal period. In order to demonstrate that meals are furnished to the employee to have the employee available for emergency call during the meal period, it must be shown that emergencies have actually occurred, or can reasonably be expected to occur, in the employer's business which have resulted, or will result, in the employer calling on the employee to perform his job during his meal period.
- (b) Meals will be regarded as furnished for a substantial noncompensatory business reason of the employer when the meals are furnished to the employee during his working hours because the employer's business is such that the employee must be restricted to a short meal period, such as 30 or 45 minutes, and because the employee could not be expected to eat elsewhere in such a short meal period.
- (c) Meals will be regarded as furnished for a substantial noncompensatory business reason of the employer when the meals are furnished to the employee during his working hours because the employee could not otherwise secure proper meals within a reasonable meal period.

Treasury Regulation §1.119-1(b) states in part that the value of lodging furnished to an employee by the employer shall be excluded from the employee's gross income if three tests are met:

- (1) The lodging is furnished on the business premises of the employer,
- (2) The lodging is furnished for the convenience of the employer, and

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(3) The employee is required to accept such lodging as a condition of his employment.

The requirement of subparagraph (3) of this paragraph that the employee is required to accept such lodging as a condition of his employment means that he be required to accept the lodging in order to enable him properly to perform the duties of his employment. Lodging will be regarded as furnished to enable the employee properly to perform the duties of his employment when, for example, the lodging is furnished because the employee is required to be available for duty at all times or because the employee could not perform the services required of him unless he is furnished such lodging.... If the tests described in subparagraphs (1), (2), and (3) of this paragraph are not met, the employee shall include in gross income the value of the lodging regardless of whether it exceeds or is less than the amount charged. In the absence of evidence to the contrary, the value of the lodging may be deemed to be equal to the amount charged.

Treasury Regulation §1.119-1(c)(1) states in part that for purposes of this section, the term "business premises of the employer" generally means the place of employment of the employee.

Treasury Regulation §1.162-1(a) states in part that business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, except items which are used as the basis for a deduction or a credit under provisions of law other than §162.... Among the items included in business expenses are management expenses, commissions, labor, supplies, incidental repairs, operating expenses of automobiles used in the trade or business, traveling expenses while away from home solely in the pursuit of a trade or business, advertising and other selling expenses, together with insurance premiums against fire, storm, theft, accident, or other similar losses in the case of a business, and rental for the use of business property.... The full amount of the allowable deduction for ordinary and necessary expenses in carrying on a business is deductible, even though such expenses exceed the gross income derived during the taxable year from such business.

Treasury Regulation 1.6001-1(a) in conjunction with Treas. Reg. 1.6001-1(c) states in part that every organization exempt from tax under IRC 501(a) must keep such permanent books or accounts or records, including inventories, as are sufficient to establish the amount of gross income, deductions, credits, or other materials required to be shown by such person in any return of such tax. Such organization shall also keep such books and records as are required to substantiate the information required by IRC 6033.

Treasury Regulation 1.6001-1(e) states that the books or records required by this section shall be kept at all times available for inspection by authorized internal revenue officers or employees, and shall be retained as long as the contents thereof may be material in the administration of any internal revenue law.

Treasury Regulation 1.6033-2(i)(2) states in part that every organization which is exempt from tax, whether or not it is required to file an annual information return, shall submit such additional information as may be required by the Internal Revenue Service for the purpose of inquiring into its exempt status.

Revenue Ruling 59-95 concerns an organization previously held exempt from Federal income tax was requested to produce a financial statement as of the end of the year and a statement of its operations

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during such year. However, its records were so incomplete that it was unable to furnish such statements. The Service held that the failure or inability to file the required information return or otherwise to comply with the provision of IRC Section 6033 and the regulations which implement it, may result in the termination of the exempt status of an organization previously held exempt, on the grounds that the organization has not established that it is observing the conditions required for the continuation of an exempt status.

In Rameses School of San Antonio, Texas, v. Commissioner, T.C. Memo 20XX-85, an organization was established as a nonprofit corporation under the laws of the State of Texas for the purpose of operating a school providing education to children and initially received recognition as an organization described in IRC §501(c)(3). The Commissioner contended that the taxpayer failed the operational test imposed pursuant to Treasury Regulation §1.501(c)(3)-1(c) on grounds that the taxpayer was operated to benefit the private interests of an individual who served as the taxpayer's executive director, president, chief executive officer, and administrator (administrator), and that part of its net earnings inured to her benefit. For instance, while the taxpayer's board approved a salary of \$5,000 per month for the administrator, the taxpayer's payroll journal showed salary amounts in excess of \$5,000 per month for certain months. Although the administrator asserted that the excess amounts were awarded as reimbursement for money that she had loaned to the taxpayer, the documentation that purportedly showed such loans had been altered. The administrator made unexplained cash withdrawals on the taxpayer's account. There were also questionable lease agreements, signed only by the administrator, that were never approved by the board. The administrator contended that the taxpayer owned the property, but if this were true, the taxpayer had leased the property from itself under the owner rental agreement. The court held that the taxpayer's tax-exempt status was properly revoked.

In Rueckwald Foundation, Inc. v. Commissioner, T.C. Memo 1974-298, the taxpayer was a foundation that qualified for an exemption from federal income taxes under IRC §501(c)(3). The qualification was subject to the understanding that the taxpayer's operations conformed to those purposes stated in its application. Because it failed to obtain a state license, the taxpayer changed its purpose. The taxpayer's founder served as both its president and chairman. His mother was an invalid and his son was in college. His mother's care fell to the founder, who found himself on the verge of bankruptcy. The taxpayer entered into a number of transactions, the result of which were to provide it with income that was exclusively used by the founder to defray his family's personal expenses. The IRS revoked the taxpayer's §501(c)(3) exemption from federal income taxation and issued a notice of deficiency. The taxpayer sought a redetermination and the court affirmed. The court held that the taxpayer's income from all sources was available for the use of the founder's family, an arrangement neither approved nor permitted under I.R.C. § 501(c)(3). The court held that the taxpayer failed to show that it qualified for income tax exemption under I.R.C. §501(c)(3).

In Foundation of Human Understanding v. United States, 88 Fed. Cl. 203, the court ruled that, in deciding whether the foundation qualified as a "church" under Internal Revenue Code §170(b)(1)(A)(i) for a three-year period including tax years 1998 through 20XX, case law dictates that because the defendant's revocation of plaintiff's church status was based on the three years audited by the Internal Revenue Service, the court's declaratory judgment power, and therefore its review of the facts in this case, is limited to the plaintiff's activities during the fiscal years 1998, 1999, and 20XX.

TAXPAYER'S POSITION:

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The Organization's response, dated November 2, 20XX, indicated that they wished to appeal the Service's proposal of revocation findings to the Office of Regional Director of Appeals.

The Organization is of the position that while it has conceded that certain personal expenses of Founder were paid by the Organization, the Organization does not operate to serve Founder's interests. The Organization asserts that it should remain tax exempt because the activities performed for the betterment of the feline community outweighs any personal benefit received by any private individuals.

The Organization indicated that it should remain exempt from federal income taxes because they were performing the activities for which it was given exemption. The Organization also indicates in its position that the Organization "is small and operated by volunteers... [and] they do not have significant expertise in the completion and filing of the necessary tax returns required." The response also indicated that the Organization received tax advice on a pro bono basis from a certified public accountant. The Organization also submitted a summary of activities, which included information about daily trips to the Organization's second facility to excuse the travel expenses as legitimate business expenses.

ORG admits that all the Organization's expenses incurred were not ordinary and necessary business expenses. However, the Organization disputed the original amount of disallowed expenses, \$, as indicated on the report issued September 20, 20XX regarding the tax year ending December 31, 20XX. The information and source documents submitted with the Organization's protest should be taken into consideration to arrive at a different disallowed expense total.

The Organization insists that the apartment of Founder, at Apartment residential apartment complex, is the Organization's primary facility and that all rent, utilities such as telephone line and internet access, and related expenses associated with the facility are deductible as business expenses. The Organization claims that there is a need to have someone available for the cats twenty-four (24) hours a day. Having someone as an on-site manager, primarily Founder, at the facility 24-hours a day, is for the convenience of the Organization, and any benefit derived from that on-site management to any individual is secondary to the primary purpose of the Organization. Therefore, the rent is includible as business expenses incurred.

The Organization maintains that Founder was made an employee of the Organization effective February 1, 20XX, and was supposed to be paid a salary in the gross amount of \$2,000 per month, per the board of directors meeting minutes dated January 8, 20XX attached with the Organization's formal response to the Service's original findings. Even though the board of director's resolution passed, no compensation in the form of wages has ever been paid to Founder. As a result, the Organization concedes that in lieu of paying salary certain personal expenses of Founder have been paid by the Organization.

The ORG asserts that its books and records to substantiate its Form 990 return were destroyed by cat urine.

GOVERNMENT'S POSITION:

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The exempt status of ORG should be revoked because it fails the operational test imposed pursuant to Treasury Regulation §1.501(c)(3)-1(c) on grounds that the Organization inures to the benefit of a private shareholder, Founder.

As president, Founder is in charge of the day-to-day operations of the Organization. Founder uses the income from the Organization as she sees fit. This is evidenced by the numerous expenses incurred by the Organization that are personal in nature. Purchases from CO-4® in no way qualify as a legitimate business expense for an Organization whose focus is on animals. Founder also made purchases at upscale department stores CO-2® and CO-11®, which the Organization claims were for clothing to wear to events on behalf of the Organization. An individual's wardrobe qualifies as a personal expense as described in IRC §262, and can not be deducted.

The Organization incurred, on average, more than seven (7) restaurant transactions per month. Some restaurant expenses incurred within one (1) or two (2) days of one another, and other transactions incurred on the same day. The frequency with which the Organization incurred the restaurant expenses does not appear to be for board meetings, adoption team meetings, or other legitimate business purposes. The Organization's restaurant expenses included numerous expenses less than thirteen dollars (\$) (the \$ is derived from the 20XX per diem rate for County, State divided by 3 meals per day). The numerous expenses under \$ also do not lend credence to the Organization's position that the meals were for meetings.

The Organization did not provide any documentation, mileage or automobile records, to substantiate its position that the gas station/convenience store purchases were for the transport of cats to-and-from adoption events, to new homes, to veterinary offices, to the Organization's second facility, etc. Although the Organization submitted a summary of activities, which included information about daily trips to the Organization's second facility (and the distance between the two facilities), the Organization did not maintain or submit daily travel and mileage logs to substantiate its travel expenses. Adequate documentation must be maintained and presented to claim deductions for travel related expenses.

The explanations alone were not sufficient to justify the Organization's position that the expenses incurred were ordinary and necessary business expenses. The submission of photographs also could not be relied upon due to the lack of dates on the photographs. Photocopies of any documentation to support the Organization's position were requested on multiple occasions. The information was requested for the entire months of April, May, July, and October, as well as sample transactions that occurred in each month throughout the year. The Organization failed to provide original receipts or photocopies to sustain its position for the above months, or any other months during the year in question. The many department store purchases, restaurant purchases, entertainment purchases, gas station/convenience store purchases, and all other expenses that could not easily be distinguished as expenses incurred by an organization in the field of animals do not qualify as ordinary and necessary business expenses as defined by IRC §162; instead, they inure to the benefit of Founder because she is in charge of the day-to-day operations of the Organization.

The Organization's claim of the rent and utilities expenses for the "facility" also inures to the benefit of Founder. A residential apartment in a residential apartment complex, notwithstanding the apartment of a private shareholder (as described in §1.501(a)-1(c)), is not a suitable location for an animal shelter. Per the County, State zoning ordinance, the apartment complex is not in an appropriate location for an animal shelter per public policy. Furthermore, the Organization should not be able to

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claim the rent expense because the Organization is not an agreeing party in the leasing agreement with the apartment complex; Founder is the only lessee of the apartment in question. Also, according to the Organization, the original lease with the apartment complex was entered into in June of 20XX, which is several months prior to the formation of the Organization in February of 20XX. Therefore, the apartment should be considered that of Founder. Not only is the apartment not leased by the Organization, Founder is not an employee. Consequently, the payment of rent and utilities of Founder inures to her benefit.

The grocery expense also inures to the benefit of Founder. According to internet research conducted for the treatment of VIR-2 and VIR-1, recommended treatment includes focusing on providing the best quality of life. This includes, but is not limited to, providing a healthy, palatable diet to encourage good nutrition, keeping the cat indoors (to protect them from exposure to disease-causing agents), and routine veterinarian check-ups (see EXHIBIT 6). This type of treatment does not appear to lend itself to 24-hour around the clock attention. In particular, the Organization's cats are not allowed outside the Organization's facility and therefore are not exposed to cats not infected with VIR-2 or VIR-1. This reduces the chances of contracting secondary diseases by the Organization's cats. Therefore, grocery expenses for Founder does not qualify as ordinary and necessary business expenses per IRC §162.

Copies of receipts and source documents were submitted in response to the Service's original report issued September 20, 20XX. Most of the submitted receipts and source documents resulted in the exclusion of the entire transaction in the questionable transactions subtotal. The grocery store receipts submitted did not result in the exclusion of the entire transaction amount. Review of the grocery store receipts to CO-18® indicated purchases for feline-related products and other items that are not specific to an organization caring for animals. The cost of the cat-related expenses, including the applicable sales taxes, was deducted from the questionable transactions subtotal shown on the original report. See EXHIBIT 7 for a breakdown of the items allowed and disallowed based on the Organization's responses, and source documents, regarding items identified by the Service as questionable transactions.

The fact that Founder is able to maintain a "normal" lifestyle without receiving adequate income since 20XX to file a federal income tax return lends to the conclusion that Founder's sole source of survival is "living" by way of the Organization. As president, Founder is able to receive a substantial benefit from the Organization by overseeing the day-to-day operations of the Organization as evidenced in the numerous personal transactions as identified in EXHIBIT 1. The \$ in questionable expenditures accounted for approximately % of the Organization's income during 20XX, and \$ in questionable expenditures accounted for approximately % of the Organization's income during 20XX.

When excess benefit transactions occur, there is an inherent risk to the exempt status of the organization. Some factors to consider regarding whether an organization remains exempt under IRC §501(c)(3) are described in the subparagraphs of Treasury Regulation §1.501(c)(3)-1(f)(2)(ii). These factors are applicable to excess benefit transactions that occurred after March 28, 20XX. The transactions in which Founder received an excess benefit were substantial as it relates to the size of the organization. There was little oversight in the Organization's financial operations to prevent further transactions prior to the Service's inquiry into the Organization's exempt status for the years under examination. Founder also has not yet made correction for the excess benefit received. Although technically the regulations don't apply for transactions that occurred before March 28, 20XX, similar principles would apply.

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The Organization admits that all of its expenses incurred were not ordinary and necessary business expenses and concedes that in lieu of paying salary certain personal expenses of Founder have been paid by the Organization. According to IRC §501(c)(3), no part of the net earnings shall inure to the benefit of any private shareholder or individual; however, Founder has received clothes, entertainment, and other benefits from her role in the Organization. The private benefit received by Founder outweighs the benefits of the legitimate activities of the Organization. As evidenced by Rameses School of San Antonio, Texas, v. Commissioner, T.C. Memo 20XX-85, and Rueckwald Foundation, Inc. v. Commissioner, T.C. Memo 1974-298, the loss of tax exempt status is warranted in which private benefit of an individual occurs.

The information submitted outside the years under examination has no influence in regards to the issue facing the Organization. As evidenced by Foundation of Human Understanding v. United States, 88 Fed. Cl. 203, in determining the outcome of the issue at hand, the review of the facts is limited to the organization's activities during the fiscal years under examination.

Not only does the Organization fail to qualify due to inuring to the benefit of a private shareholder or individual, the Organization also fails to qualify for exemption due to failing to meet the requirements of Treasury Regulation 1.6033-2(i)(2). As referenced by Revenue Ruling 59-95, an organization exempt from taxation under IRC §501(a) that fails to submit such additional information as may be required by the Internal Revenue Service for the purpose of inquiring into its exempt status may result in the termination of its exempt status. The Organization did not provide documentation to substantiate numerous expenses incurred by the Organization. Although the Organization's supporting documents may have been contaminated by cat urine, this does not absolve the Organization of its responsibility. Obtaining photocopies of the documents from the vendor, or of the documents on hand, were alternative ways to provide the necessary documentation.

The Organization has failed the operational test in various ways. The inurement of an individual, Founder, outweighs the benefit of the charitable activities provided by the Organization. The Organization also failed to maintain adequate records to substantiate the information provided on its annual Form 990 return. The Organization's failures in the operational test outweigh its charitable activities.

CONCLUSION:

ORG does not qualify for tax exempt status under Internal Revenue Code Section 501(a) as described in Section 501(c)(3). The Organization has failed to show that it meets the operational test imposed pursuant to Internal Revenue Code §501(c)(3) and Treasury Regulation §1.501(c)(3)-1(c) on grounds that the Organization is operating to benefit the private interests of an individual, Founder. The Organization also has failed to qualify for exemption due to failing to meet the requirements of Internal Revenue Code §6033 and Treasury Regulation 1.6033-2(i)(2) in which an organization exempt from taxation under IRC §501(a) shall submit such additional information as may be required by the Internal Revenue Service for the purpose of inquiring into its exempt status.

Revocation of the tax exempt status of ORG is proposed with an effective date of January 1, 20XX.